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## **THE COMMODITY FUTURES TRADING COMMISSION RESCINDS A COMMON FAMILY OFFICE EXEMPTION**

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The recent implementation of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”) requirements has significantly changed the Commodity Exchange Act (the “CEA”). As a result of these changes, family offices that trade in commodities and derivatives should review their compliance with applicable law. During the first quarter of 2012, the Commodity Futures Trading Commission (the “CFTC”) radically overhauled the definitions of Commodity Trading Adviser (“CTA”) and Commodity Pool Operator (“CPO”) and the available exemptions from registration as a CTA and/or CPO for family offices. Unlike the revisions to the Investment Advisers Act of 1940 (the “IAA”) made by the Securities and Exchange Commission (the “SEC”), the CFTC has not provided any “Family Office Exemption.” As a result of the radical changes in rules and regulations of the CEA, family offices must reaffirm an exemption under the CEA with the National Futures Association (the “NFA”) or seek a no-action letter from the CFTC to ensure compliance. Although wealth industry professionals and family office groups have requested that the CFTC promulgate a new “Family Office Exemption”, no such exemption has yet been provided.

### **Broadening the Definition of Commodity Trading Adviser**

Similar to the definition of an investment adviser, a CTA advises others for profit on the purchase, sale, or value of commodities, including over-the-counter derivatives (“OTC Derivatives”). CTAs are required to register with the CFTC through the NFA. However, under Section 4(m)(1) of the CEA, an adviser is exempt from registering as a CTA if it has not provided commodities trading advice during the previous twelve (12) months to more than fifteen (15) people. This is a self-executing exemption, which does not require any filings.

As a part of a Dodd-Frank Act compliance review, family offices should be aware of potential liability as a CTA. Registration with the CFTC will require additional recordkeeping and compliance, along with disclosures to regulators that family offices typically prefer to avoid in order to maintain privacy and confidentiality. As a result, family offices now need to carefully structure any commodities investment program to prevent triggering registration.



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## **Rescinding the "Family Office Exemption" under the CEA**

Similar to an operator of a hedge fund or a mutual fund, a CPO is defined as an individual or entity which operates an enterprise in which funds were contributed by multiple investors to trade in OTC derivatives, futures, options, or retail off-exchange forex contracts or to invest in another CPO. Prior to February 9, 2012, family offices, which typically fall under this broad definition, could rely on several exemptions to avoid CPO registration. In particular, family offices relied upon Rule 4.13(a)(4) of the CEA, which exempted pools in which all the investors were “knowledgeable employees” and “qualified purchasers.” However, the CFTC has rescinded this exemption, leaving family offices scrambling for a new exemption. Nevertheless, several exemptions still exist that provide some relief. Under Rule 4.13(a)(1) of the CEA, an entity is exempted from registration as a CPO if: (i) The CPO only operates a single pool; (ii) The CPO does not receive compensation; and, (iii) The CPO is not otherwise required to register with the CFTC (*i.e.* as a CTA).

Family offices may also be able to rely on Rule 4.13(a)(2) of the CEA, which exempts a CPO from registration, if its pools have: (i) aggregate contributions of \$400,000 or less, and (ii) less than fifteen participants in the pools. While this seems restrictive, the contribution and participant limits do not factor in: (i) the CPO; (ii) its principals; or (iii) the principals’ immediate family members or any other relative living in the same household. It should be noted, however that, these exemptions are not self-executing and notice must be filed electronically with the NFA.

Alternatively, family offices may seek a no-action letter from the CFTC in order to obtain exemptive relief. The CFTC has provided at least 34 no-action letters to family offices regarding exemptions and has repeatedly affirmed that it does not intend to regulate family offices. As discussed above, the rules and regulations under the CEA are likely to continue to change as the CFTC attempts to harmonize its rulemaking with the rulemaking of the SEC. It is likely that the CFTC will conduct new rulemaking to provide an exemption similar to the “Family Office Exemption” under the IAA, but there is no assurance at this time that the CFTC will create this exemption.